S&P Global
Ratings

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Summary:

Central Contra Costa Sanitary District, California; Water/Sewer

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Table Of Contents

Summary:

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Credit Profile		
US$20.454 mil wastewtr rev rfdg bnds ser 2018A due 09/01/2029		
Long Term Rating	AAA/Stable	New
US$4.598 mil wastewtr rev rfdg bnds ser 2018B due 09/01/2023		
Long Term Rating	AAA/Stable	New
Central Contra Costa San Dist Wtr & Swr		
Long Term Rating	AAA/Stable	Affirmed

Rationale

S&P Global Ratings has assigned its 'AAA' long-term rating to Central Contra Costa Sanitary District, Calif.'s series 2018A and B wastewater revenue refunding bonds. At the same time, S&P Global Ratings affirmed its 'AAA' long-term rating and underlying rating (SPUR) on the district's existing parity obligations. The outlook is stable.

The ratings reflect, in our opinion, the combination of an extremely strong enterprise risk profile and an extremely strong financial risk profile.

The enterprise risk profile reflects our view of the district's:

- Service area participation in the broad and diverse San Francisco Bay Area economic base;
- Very low industry risk as a monopolistic service provider of an essential public utility;
- Demonstrated ability and willingness to increase rates annually, and service rates that we believe are affordable for the region in the context of the service area's very strong income levels and moderately low poverty rate; and
- Strong operational management practices and policies, which in our view indicates a strong alignment of operations and management's strategic goals.

The financial risk profile reflects our view of the district's:

- Very strong historical all-in debt service coverage (DSC) metrics that we believe the district will continue to produce, reflecting its five-year forecast and revenue requirements to support future debt issuances;
- Extremely strong liquidity profile that we believe is sustainable and aligned with the district's robust reserve policy;
- Low-to-moderate leverage reflecting a pro forma debt-to-capitalization ratio of 26%, after including future planned debt issuances to support its extensive capital improvement program (CIP); and
- Strong financial management practices and policies, indicating the highest level of internal financial controls and best practices are in place.

The district has a predominantly locally derived revenue base. Local service charges, derived through an autonomous rate-setting process, represent virtually all of the district's revenues. This, coupled with operating expense flexibility, limits exposure to federal revenues.

The district is issuing the series 2018A and B bonds to refinance all of the series 2009A and B certificates of participation. We view the bond provisions as credit neutral. The district's pledge of ad valorem property taxes and net revenues secure the bonds. Key bond provisions include a rate covenant set at 1.25x annual debt service from net revenues (excluding capacity fees) together with tax revenues and an additional bonds test set at 1.25x maximum annual debt service (MADS).

Enterprise risk

The district operates and maintains wastewater facilities and a collection system for a largely residential base approximately 30 miles east of San Francisco. It covers a population of about 488,000 and includes Clayton, Concord, Danville, Lafayette, Martinez, Moraga, Orinda, Pleasant Hill, San Ramon, and Walnut Creek, all in Contra Costa County. We view the service area's income levels as very strong reflecting the county's median household effective buying income (MHHEBI), which was 146% of the national median. For the period from 2016-2019, we expect that local economic growth will be strong, with the average annual change in gross county product to be about 3.2%, which exceeds the national metric of about 2.4%. The customer base is stable, in our view, with modest growth in the past five years. The district served 116,404 service accounts in fiscal year 2017. About 81% of sewer service charge revenue in fiscal 2017 was residential, and there is no significant customer base concentration. The top 10 customers account for approximately 19% of total operating revenues. The leading customer--the City of Concord--accounts for about 15.6% of total operating revenues. We understand the district entered into a wholesale contract in the 1970s with Concord to provide wastewater treatment and disposal services for both Concord and Clayton, which generates stable revenues in our view.

We view the district's market position as very strong reflecting its affordable service rates, particularly relative to the area's very strong income levels, and moderately low county poverty rate. We view the district's service rates as affordable, which provides management with revenue-raising flexibility. Customers are charged a flat annual rate on the property tax bill. The annual single-family residence sewer charge was $530 in fiscal 2018, equivalent to about $44.2 per month, and rose to $567 in fiscal 2019 (or about $47.3 per month). We view this level to be affordable at about 0.8% of the county's MHHEBI. The district raised rates between 5% and 9% in the past few years. It has not yet adopted future rate increases, but plans to increase rates by 7% in fiscal years 2020 and 2021. The county poverty rate as reported by the U.S. Dept. of Agriculture is 10.5%, which we view as moderately low and not a material source of resistance to revenue raising. In addition to service charge revenue from direct customers, the district receives revenue from the City of Concord under a long-term agreement to treat a portion of Concord's wastewater. Concord pays the district the portion of operating costs and capital costs allocated to it based on usage. The district also participates in the county's Teeter Plan, whereby it receives annually 100% of the secured property tax levies to which it otherwise is entitled, regardless of whether the county has fully collected the levies.

Reflecting our operational management assessment, we view the district to be a '1' on a six-point scale, with '1' being the strongest. In our view, the district's strong operational management policies indicate the existence of both strong internal governance and controls, and asset management policies. The district's treatment plant in Martinez treats an average dry weather daily flow of about 35 million gallons of wastewater per day (mgd). The treatment plant has a capacity of 54 mgd of dry weather flow and a peak wet weather flow of 230 mgd, and the district projects that its treatment capacity is sufficient to support secondary treatment needs for the foreseeable future. Most wastewater is treated to a secondary level and discharged into Suisun Bay. A portion of wastewater (about 600 million gallons a year) is treated to a tertiary level and used as recycled water. Average daily flows in recent periods have been lower as a result of drought conditions and water conservation. The treatment plant's regulatory regional permit is current and expires in June 2019. Management reports that the system's assets are reviewed frequently to identify capital improvements. In June 2017, the district adopted a new long-term master plan that identified approximately $1.8 billion of various upgrades and improvements to the treatment and conveyance systems over a 20-year period. The recommended capital projects from the master plan were separated into four programs including the treatment plant, collection system, recycled water system, and general improvements. Some of key drivers for long-term planning include managing aging infrastructure, and complying with future regulatory requirements.

Management reviews and adjusts rates regularly, and periodically engages external consultants to perform in-depth rate analyses. The district also has a formal succession plan for key staff members, and we believe management demonstrates great breadth of knowledge in its wastewater treatment operations and encourages staff to obtain higher levels of treatment certifications. The district maintains a strategic plan with robust external customer outreach.

Consistent with our "Methodology: Industry Risk" (published Nov. 19, 2013 on RatingsDirect), we consider industry risk for wastewater utilities to be very low, the most favorable assessment possible on a six-point scale, with '1' being the best.

Financial risk

The district's financial performance has been very strong, in our view, and we anticipate that performance will be comparable going forward despite plans for future debt issuances. The district collects revenue from a variety of sources, including sewer service charges, ad valorem property taxes, and capacity charges (one-time growth-related fees). Based on the district's audited financial statements, we calculate all-in coverage of no less than 5x during the past five fiscal years through 2017. Based on management's forecast through fiscal year 2022, which we view as reasonable, we calculate all-in coverage will continue to remain above 5x going forward as service rates are adjusted to continue meeting rising operating expenses and the district's pay-as-you-go capital needs. Key assumptions in the forecast include increases in operating revenues from proposed rate adjustments, continued increases in operating expenses, and additional leverage due to planned new money debt issuances of $185 million during the forecast period. The district also maintains a board policy DSC target to exceed 2x (after excluding capacity fees).

The district's current 10-year CIP through 2028 totals about $806 million. Of that total, treatment plant projects account for 53%, collection system (38%), general improvements (3%), and recycled water projects (3%). Over the past decade, management reports that historical capital investment has averaged about $30 million annually. As the district implements the recommendations of the 2017 master plan, it will be increasing annual capital spending to about $80 million annually over the next 10 years. We believe this higher level of annual capital spending could potentially be funded through a combination of modest rate increases, operating cost savings, and debt financing. The district's forecast assumes new money debt issuances of $50 million in fiscal 2020 and $135 million in fiscal 2022, which is subject to board approval. We view the district's pro forma leverage level as low-to-moderate reflecting a pro forma debt-to-capitalization ratio of about 26%, which includes the plan to fund about 23% of the 10-year CIP with projected debt issuances.

The district has maintained an extremely strong liquidity position that we anticipate will likely remain sustainable in the near future. Historical unrestricted cash and investment reserves have modestly increased in recent years to about $80 million, equivalent to 355 days of operating expenses in fiscal year 2017. The district's liquidity levels have remained no less than 250 days in the past five fiscal years. The district's reserve policy segregates its cash into two primary reserve categories: a five-months' reserve target for operations, and a sewer construction reserve target of 50% of the next year's cash funded portion of the capital budget. Reflecting management's forecast, we anticipate that reserves will remain stable in the near term.

Based on our financial management assessment, we view the district to be a '1' on a six-point scale, with '1' being the strongest. We believe that the district's practices are strong, comprehensive, and support high credit quality. Revenue and expenses assumptions are reasonable, in our view, and interim financial reporting is provided to the district through monthly reports to the board. The long-term planning process is rigorous, and the detailed 10-year CIP is annually updated. We view the district's reserve policy as robust, articulating a rationale for maintaining its extremely strong liquidity position. Financial planning and operational information are relatively easily obtained, as the district's budget, financial statements, and master plans are readily available on its website. The district participates in the Contra Costa County Employees' Retirement Association Retirement System and has been making its necessary annual employer contributions. The district has established a pension prefunding trust recently and contributed $5.4 million in fiscal year 2018. The district also provides other post employment benefits (OPEB), and maintains about a 50% funded ratio on its OPEB plan. The district has been making additional discretionary contributions to the pension and OPEB plans to increase its funded ratios in recent years.

Outlook

The stable outlook reflects our anticipation the district will continue to adjust service rates to meet its revenue requirements, thereby producing continued wide margins and very strong all-in coverage metrics. We further anticipate that the district will fund its extensive CIP using a combination of pay-as-you-go and projected debt-financing during the next 10 years.

Downside scenario

We don't anticipate lowering the rating over the two-year outlook horizon as long as the district continues to produce financial metrics that are consistent with or exceed historical trends, while successfully funding its capital plan. However, any unexpected economic or financial shock that significantly disrupts the system's operations or unanticipated and extraordinarily large change in the CIP that could alter related financial metrics could present downward pressure on the rating or outlook.

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.